Paving the Way Forward for Rural Finance
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Case Study

Rural Financial Institutions:
Restructuring and Post Restructure Results

Rediscovering Rural Finance by Retooling the Existing Institutions

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A. THE PROLOGUE

India is home to the largest concentration of farmers in the world and is also a country where agriculture accounts for a relatively high share of GDP at 24.7 percent. Furthermore, 56.70 percent of the workforce is still engaged in agriculture. Like the proverbial curate's egg, India's rural finance system is good in parts. The good part is that, unlike many developing countries, the country has a rural finance system that is extensive and well organized. There are thirty State Cooperative Banks and 369 District Central Cooperative Banks (DCCBs) with network of 13,635 branches, 92,219 Primary Agriculture Credit Societies and 196 Regional Rural Banks (RRBs) with a network of 14,358 branches. The mainstream Commercial Banks have 32,538 rural and 14,608 semi urban branches whose portfolio is predominantly in agriculture and allied sectors. In addition, there are twenty State Cooperative Agriculture Development Banks and 739 Primary Agriculture Development Banks, which are technically not banks, but do disburse credit for investment activities in agriculture through their network of 2001 branches.

However, until the mid nineties, the entire rural finance system was characterized by a lack of operational freedom due to all pervasive governmental intervention as well as the control of all aspects of the functioning of the institutions by the Central Bank of the country, the Reserve Bank of India (RBI). From the mid-1950s to the mid 1970s, the main concern of the government was to increase food production, but during the mid 1970s the focus shifted to poverty alleviation through subsidized credit. The predominant aim of policy makers from the 1950s to 1980s was to extend the outreach of the rural finance system and to increase the level of credit flow to agriculture and to poverty alleviation programs. The issues relating to the development of a proper banking system or rural financial market involving, proper loan appraisal, recovery and recycling, resource mobilization, mobilization of savings and sustainability and viability of the operations were ignored or forgotten. The outcome of these policies was a rural finance system with a poor resource base, high transaction costs, low or negative margins, mounting bad debts and continuous losses. By 1994-95 India had reached a stage where the financial needs of the rural population could not be met without a complete overhaul of the existing system or the creation of an entirely new system.

Banking Sector Reforms

It was in such a scenario that the Government of India initiated financial sector and banking sector reforms from 1991-92 onwards. However, the situation in the rural finance sector was hardly conducive to an effective credit delivery system, especially in the context of the emerging competitive environment in the wake of the financial sector reforms. There was an imperative need for the rural financial institutions (RFIs) to be sensitive to the concept of cost effectiveness, commercial orientation and professionalism. To bring about such sensitivity a total diagnosis of the ills afflicting these institutions was necessary. It was recognized that any resulting program should encompass the 'critical minimum effort' to simultaneously attack all the crucial factors that impinge on the viable functioning of these banks. The remedy to these problems was to allow these institutions to function truly as financial intermediaries based on market forces rather than compelling them into the role of mere conduits of directed credit. The institutions should therefore be left free to determine the terms and pace of their resource mobilization and correspondingly those for lending and investment. This implies that the system should allow the institutions to devise their own policies for mobilization of resources and deployment thereof in the most profitable direction.

Development Action Planning

Keeping this philosophy as the cornerstone, in 1994-95, the apex institution for rural finance - National Bank for Agriculture and Rural Development (NABARD) had initiated the process of drawing up of Development Action Plans (DAP) for each of the rural finance institutions (RFIs). This initiative represents a paradigm shift from institutional development that is top-down to bottom-up and self-targeting. It was also a tool for building RFIs' self esteem, accountability and services that are relevant to their customers. The basic philosophy of the DAP was to prepare institution specific action plans by taking into account their strengths and weaknesses, diagnosing the past and looking into the future, anticipating the course of events and preparing coping strategies, the implementation of which would improve their viability. In order to assess the viability status of the institution, a thorough analysis of the various aspects - such as financial, organizational, systems and procedures and human resource development - having bearing on the viability of the credit institutions was envisaged. On the basis of such an analysis, the factors that affect the viability of the banks were identified and specific remedial measures were mapped out. The DAPs contained realistic projections for growth in the operations of the institutions based on their optimal performance, potential available in the area of operation and their capacity to exploit such potential.

Furthermore, the impact of accumulated losses and loan losses and other unrealizable assets were also estimated on a realistic basis through this exercise. This was an important component of the entire exercise, which had to be kept in view while devising the package of time bound measures for enabling the institutions to become viable. The institutions in losses were attuned to achieve current viability and later sustainable viability. Current viability denoted the ability of the institution to meet the cost of management and the risk cost out of the gross financial margin available and be in a position to earn reasonable profit. Sustainable viability indicates the ability of the institution to completely wipe out all accumulated losses and to adequately provide for bad debts/assets and start afresh with a clean balance sheet. A distinctive feature of the preparation of DAP is the break even analysis which projected the business levels which the institutions have to aim for if they have to achieve current viability. It was also realized that the DAPs have to be backed up by a certain level of performance obligation by all of the stakeholders concerned. Accordingly, in 1994-95 the Finance Minister of the Government of India in his budget speech indicated that all the institutions concerned would enter into the Memoranda of Understanding (MoU) with the major stakeholders to ensure that these DAPs were implemented in a time bound manner. Their performance obligations were specifically pinned down through the MoUs.

The DAP exercise was also facilitated by deregulation in the banking sector. From 1994 onwards, Reserve Bank of India gradually deregulated the deposit and lending interest rates - first for the Cooperative Banks and later for RRBs and Commercial Banks. While broad sectoral targets for agriculture and other priority sectors were retained, specific directions of credit flow were withdrawn. The emphasis on subsidized credit programs also disappeared. Banks were given the autonomy to devise and market their saving and credit products. These elements in the liberalization process enabled the banks to recast their lending and savings programs to take care of the profitability aspect. It would also be pertinent to mention that until the early 1990s the banking sector in India was not in tune with the internationally accepted norms. These practices, such as capital adequacy norms, exposure limits, asset classification, provisioning norms, accounting rules, valuation norms etc. as per the Basle recommendations, were implemented gradually for Commercial Banks, RRBs and Cooperative Banks starting in 1992. The Reserve Bank of India also introduced greater levels of transparency and standards of disclosure. A positive externality of the reform process has been the building up of the institutional architecture in terms of markets and the creation of enabling environment through technological and legal infrastructure and the improvement of managerial competence.

In the background of these reforms in the financial sector and the process of liberalization, the DAP exercise was utilized by many institutions to recast their systems and procedures, lending and deposit taking programs, strategies of recovery and human resource management practices to emerge profitable while at the same time not neglecting the outreach aspect of their credit programs. Though the results of these exercises have been mixed, a larger number of institutions, both in case of District Central Cooperative Banks and the Regional Rural Banks, have been successfully turned around, becoming profitable while continuing to remain as major purveyors of agricultural credit. By 2001-02, 246 out of the 369 District Central Cooperative Banks and 167 of the 196 Regional Rural Banks became profitable.

Two institutions in North-West India, a District Central Cooperative Bank and a Regional Rural Bank, which have successfully turned around using the the DAP as a basis, are discussed below:

B. SANGRUR CENTRAL COOPERATIVE BANK

The Sangrur Central Cooperative Bank was established in 1951 and caters to the district of the same name situated in Southern part of the State of Punjab. The CCB was originally meant only to be a federating structure for the affiliated societies. However, over the years, in India these banks evolved into full-fledged banking institutions catering to various banking needs through their branch network. They were recognized as Banks under the Banking Regulation Act of 1949. The Sangrur CCB carries out its operations through the network of 64 branches and 275 Primary Agriculture Credit Societies. The Bank is owned by the 1,177 affiliated primary societies (of which the 275 Primary Agriculture Credit Societies are also a subset). It is managed by a Board of Directors consisting of eight Directors elected from the societies and three official directors nominated by the State Government and is headed by a Chairman. The day-to-day affairs of the Bank are managed by a team of officers led by the District Manager who is the Chief Executive Officer of the Bank. The Bank is staffed by 125 Managers and Officers, 76 Clerks and 157 Subordinate Staff.

Before Restructuring

At the start of the process of restructuring, the bank was basically a single product bank. It provided short-term crop loans, which were disbursed through the societies. There were negligible banking operations at the branches and it did not place much emphasis on savings. The bank lost Rs.9.66 million in 1993-94 and made a nominal profit of Rs.0.14 million in 1994-95, but still had accumulated losses of Rs.23.5 million. With the DAP as its plan of action the bank focused on the areas on which it had to concentrate for turning around the bank in the shortest possible time. The most effort went towards increasing the levels of business, reducing the cost of resources as well as operations and increasing loan recovery. Table-1 gives the financial indicators of the bank for the year 1994-95 and for the three-year period from 2000-01 to 2002-03.

TABLE-1
SANGRUR CENTRAL COOPERATIVE BANK.

Sr. No.		1994-95	2000-01	2001-02	2002-03
Outreach Indicators					
1	No. of borrowers	50,366	77,912	93,870	114,234
2	Outstanding loan portfolio *	755	2048	2414	3473
3	No of depositors	68,375	135,373	153,833	162,216
4	Outstanding deposit portfolio *	547	1,636	1,846	2079
5	Loans to Total Assets	61.60	69.83	62	82.62
6	Credit Deposit Ratio	115.62	125.14	130.77	167.05
Sustainability Indicators					
7	Financial Margin (Difference between average cost of funds and average yield on assets)	2.67	3.64	3.97	4.02
8	Net Margin(After factoring in Risk Cost and Cost of Management into Financial Margin)	0.06	0.03	0.52	2.16
9	Cost of Management (Operating Costs to Average assets)	2.87	3.60	3.10	2.48
10	Return on assets	0.01	0.17	1.02	1.14
11	Return on Net worth	0.10	2.94	20.77	28.81
12	Capital Adequacy Ratio	16.09	9.31	8.02	5.71
13	Loan recovery percentage	89	93	93	95
14	NPA Ratio(Ratio of Non Performing Assets to Total Loans Outstanding)	12.48	4.84	4.76	3.70
15	Profit / Loss *	0.14	0.04	30	46
16	Owned Funds * (Share Capital + Reserves)	76	141	146	158.
17	Borrowings *(from refinancing institutions)	410	901	1,143	1,925

* in million Indian Rupees; Except (1) and (3) all other figures are in percentages.

Credit

In addition to the existing short-term crop loan, the bank introduced a credit card for the farmers known as *Kisan* Credit Card (KCC) which allows the farmers to withdraw and repay based on their cash flow patterns. The KCC turned out to be a very popular loan product and was issued to 87,556 borrowers as of March 31, 2003. The bank has also devised an omnibus credit limit for medium and large farmers known as the Revolving Cash Credit.

Based on the collateral available with the farmer in form of land, a credit limit was fixed, of which a part is covered for investment purposes and another part for consumption needs. This product is priced slightly higher so that it brings in more revenue inflow to the bank. The bank has 7,516 of these loan accounts. It has also introduced a scheme for financing motorbikes for the farmers, wherein there are 133 loan accounts.

The bank has extended credit to number of long-term investment activities in agriculture such as irrigation pump sets, repair of tube wells, combine harvesters, reapers, threshers, dairy animals, poultry etc. This was bold step for a bank that was known only as a short-term financing bank. It has also taken up financing of rural godowns for grain storage and other cold food storage under special schemes launched by government. Under its non-farm loans program for rural entrepreneurs it has extended credit to a myriad of activities, ranging from agricultural implements manufacturing to rural hotels and rural school buildings to timber mills. The motto of the Credit Department of the Bank is - show us any economic activity, our Bank has a scheme or will have a scheme to finance it. This underlines the fact that the credit products of the bank were a result of its quick responses to the changing economic and occupation profile of the people in its area of operations.

The bank is also a big player in the microfinance sector in the district with nearly 150 self-help groups being linked to it, of which forty-six of these groups have already received credit. It has trained a core group of officials in microfinance, who have been given the task of promoting and financing self-help groups.

Traditional agricultural financing in India, as in the Punjab region, has focused on men since, as in all patriarchal societies, the land ownership is in the name of the male family members. But the bank has taken its role in women's empowerment seriously, and has been focusing specifically on women as borrowers, especially in non-land based activities. During 2002-03 it advanced Rs 71.5 million to women. An all-women farmers' club formed by the bank is one of the first of its kind in the state. This club played a pioneering role in organizing training activities for rural women to help them become economically independent.

Savings

The bank realized that it had to focus more on rural savings to improve its clientele as well as its own resource base. Therefore, one of the schemes it introduced was the Deposit linked Insurance Scheme under which the depositors have to keep a minimum balance of Rs.1100 in a Saving Bank Account. By keeping this minimum balance the bank pays a premium to the insurance company thereby providing the depositor with accident and death insurance. This unique scheme attracted a large number of depositors to the bank. The bank has also utilized its new credit products and their clients to tap more deposit sources. The bank has been showing a consistent growth in deposits, having posted a growth of 12.60 percent this year, which was more than the average deposit growth rate of Commercial Banks in the district. The bank also has a good share of low cost saving deposits, currently forty-five percent of total deposits.

Human Resources

The level of staff motivation is high as can be discerned from their involvement in business of the bank. The positive factors are the leadership role played by the Chief Executive Officer and facilitating the role of the NABARD's District Development Manager, who works in the district. They maintain a constant dialogue with staff regarding the business goals that the bank must reach and the efforts needed for that. It is a fact that a majority of staff members of the bank have not been educated beyond high school nor have they received any professional education. But the strength of the human resources of the bank is their local feel and the complete knowledge of the area of operation of the bank and the close liaison, that they maintain with their clientele. In addition they have the experience of working with the banking institution for a long period. The bank was prudent to hire professionally educated staff - a Chartered Accountant (CA) and two MBAs who look after the appraisal of advances, DAPs, investments as well as supervision and regulation. The Technical Monitoring and Evaluation Cell headed by the CA was instrumental in diversifying the loan portfolio of the bank, making available the skills required for loan appraisals.

Governance

As in case of other Central Cooperative Banks in India, an elected Board of Directors heads this bank. The directors are neither professionals nor bankers, but act in a manner which is beneficial to the bank. Their foremost goal is to maintain the viability of the institution as well as meeting the credit needs of their constituents. The elected Board respects the professional banking advice given by the executives of the bank and its experienced staff. There were instances of interference from the State government in various matters of decision-making. The management, however, politely refused to obey the line of the State government, wherever it was not in the interests of the bank.

Net Supplier of Credit

With a Credit-Deposit Ratio ranging from 125 percent in 2000-01 to 167 percent in 2002-03, the branch network of the bank is a net supplier of credit to the rural areas. However, this position has not impinged on the liquidity of the bank, as in the Indian financial system, ample refinance resources are available at competitive, market-based rates of interest. The bank borrowed Rs.900 million in 2000-01, which increased to Rs.1925 million in 2002-03. Of these amounts, between 77 to 85 percent were lent to it by NABARD and the rest by the State Cooperative Bank.

Outreach

In 1994-95 the bank had a client base of 50,336 borrowers and 68,375 depositors. Currently it caters to 114,234 loan accounts and 162,216 deposit accounts. The borrower client base of the bank now constitutes forty-four percent of the rural families in the district. Thus the growth in the breadth of its outreach is unparalleled among the banking institutions both in the district and elsewhere. The extension of its outreach had also been facilitated by decentralization and delegation of powers. Earlier branches did not have any loan sanctioning powers. The Branch managers have been delegated powers to sanction term loans up to Rs.50,000 and to sanction all crop loans. The Chief Executive Officer has powers up to Rs.0.50 million and beyond that decisions are made by a Loan Sanction Committee consisting of the CEO, Head of Credit Division and the Chairman.

There is a general perception that cooperatives limit their services to members and as such, they cannot cater to a broad client profile in an area. However, Sangrur CCB does not allow this technicality to come in the way of extending its outreach - any new customer desirous of availing a credit facility is enrolled as a nominal member of the bank and his/her loan proposal is taken up for appraisal.

Sustainability

In 1994-95, the cost of management of the bank was 2.87 percent, this increased to 3.60 percent in 2000-01 and began declining in 2002-03, falling to 2.48 percent. The financial margin was 2.67 percent in the year 1994-95. It increased to 3.64 percent in 2000-01 and further to 4.02 percent in 2002-03. The Return on Assets, which was 0.01 percent in 1994-95 increased to 0.17 percent in 2000-01 and further to 1.14 percent in 2002-03. The bank began making a profit in 1994-95 showing a modest profit of Rs.0.14 million. But this was interrupted in 1996-97 when it suffered a loss of Rs.43.46 million, as it had to make huge provisions due to the application of prudential norms to the cooperative banks in India. Again it made a loss of Rs.7.56 million in 1999-2000 as it had to pay heavy amounts as back-pay to the employees and contribute to their pension funds. But from 2000-01 onwards the growth in profits has been steady and by generating a profit of Rs 46 million during 2002-03 it wiped out its accumulated losses and reached its set goal of sustainable viability.

One of the steps that the bank initiated in its viability planning is the focused attention to loss making branches. In 2001-02 five branches were still making losses. These branches were adopted by the senior officials associated with the Bank with a personal responsibility to nurse them and turn the into profit centers. This exercise has borne fruit in the sense that all sixty-four branches are now profitable.

Subsidy Giver

Rural Financial Institutions in developing countries have been traditionally subsidy dependent in terms of capital infusions from the government, subsidies to run credit program, cheap refinancing, and receiving donor funds. But this bank has been a subsidizer of the State Government's Department of Cooperation. Until this most recent financial year it had twenty-eight employees from the Department whose cost was Rs.4.05 million per year to the bank but who did not contribute to the business of the bank. The bank’s Board of Directors persuaded the government to take these employeesback. Yet even now travel and other miscellaneous expenses of the officials of the Department of Cooperation in the District, nearly Rs.1.5 million per annum, are borne by the Bank.

Loan Recovery

The bank had a reasonable percentage of loan recovery at eight-nine percent in 1994-95. However, its aim was to further increase the recovery rate and not to allow any loan to turn into a Non-Performing Asset. At the branch level, every month, the repayments due are assessed and based on that assessment the borrowers are contacted personally by the branch staff. Furthermore, the unwritten rule of the bank is to ensure higher credit for prompt repayment also has a positive effect. Due to this continuous monitoring and efforts, the Bank has now reached a ninety-five percent recovery level.

Diversification of Business

Not only has the Bank diversified its credit portfolio, but it has introduced other products to take care of its customers' needs. These include the issue of Demand Drafts by making arrangements with two private sector banks. Hitherto the banks were not able to leverage their surplus funds due to prohibitions by RBI. As this prohibition was also relaxed, the Bank was able to judiciously deploy some surplus funds in bonds and treasury bills and earn good returns totaling Rs 35.39 million in 2002-03.

The Outlook

With the largest outreach among the CCBs in Punjab, with the most diversified credit portfolio, with dedicated and motivated staff, with a forward looking and innovative leadership, with a progressive board of directors and having wiped out its accumulated loses, Sangrur CCB looks forward to future to further expand and diversify its outreach while continuing to remain a viable institution. However, further reforms will be needed if the bank is keep pace with the dynamic financial sector scenario.

C. GURGAON GRAMIN BANK

In India Regional Rural Banks (RRBs) were established as low cost banks as an alternative to Commercial Banks and Cooperative Banks to cater to the needs of rural credit. These banks were set up under a separate statute - the Regional Rural Banks Act of 1976. These banks were sponsored by a Commercial bank, which owned thirty-five percent of the share capital and provided technical and managerial support to the banks. The sponsor bank also provided the key personnel to the RRB. The Government of India owned fifty percent of the share capital and fifteen percent is owned by the State government.

Gurgaon Gramin Bank is one such RRB established in 1976. It covers the four districts of Gurgaon, Faridabad, Rewari and Mahindergarh in southern part of the State of Haryana. Presently it has a network of 119 branches. The Bank is managed by a Board of Directors consisting of eight Directors and a Chairman. Four Directors represent the Government of India and two each the State Government and the Sponsor Bank - Syndicate Bank. The Chairman is an officer on secondment from the sponsor bank. The Chairman is the Chief Executive Officer of the Bank and is assisted by two General Managers and eleven Senior Managers. The Bank is staffed by 350 officers, 346 clerks and 128 subordinate staff.

Before Restructuring

Until 1994-95, the Regional Rural Banks operated under highly restrictive environment where even the smallest of the administrative decisions, what to speak of policy matters, were taken at the level of Government or RBI. Chaffing under these conditions the banks experienced continuous losses, with high level of overdue loans and low returns on advances.

In 1994-95 Gurgaon Gramin Bank was in precarious shape financially with a negative net margin of 0.88 percent, a low loan recovery of fifty-one percent and accumulated losses of Rs 67.4 million. This bank has also utilized the Development Action Planning process to chalk out a program for achieving sustainable viability without loosing its focus on outreach. Table 2 gives the financial parameters of the bank for 1994-95 and for the three-year period from 2000-01 to 2002-03.

TABLE-2
GURGAON GRAMIN BANK

Sl No		1994-95	2000-01	2001-02	2002-03
Outreach Indicators					
1	No. of borrowers	119,697	89,684	100,152	114,763
2	Outstanding loan portfolio *	986	2395	2468	2493
3	No of depositors	522,994	525,879	528,865	546,328
4	Outstanding deposit portfolio *	2,205	5382	5,811	6,027
5	Loans to Total Assets	40.44	35.16	32.44	31.39
6	Credit Deposit Ratio	44.74	44.51	42.47	43.88
Sustainability Indicators					
7	Financial Margin (Difference between average cost of funds and average yield on assets)	2.71	5.35	5.68	4.70
8	Net Margin (After factoring in Risk Cost and Cost of Management into Financial Margin)	(-) 0.88	3.55	4.02	4.09
9	Cost of Management (Operating Costs to Average assets)	3.18	2.32	2.45	2.45
10	Return on assets	(-) 0.83	3.26	4.03	4.09
11	Return on Net worth	(-) 36.15	31.24	29.09	24.22
12	Capital Adequacy Ratio	7.92	21.34	28.64	38.24
13	Loan recovery percentage	51	86	86	88
14	NPA Ratio (Ratio of Non Performing Assets to Total Loans Outstanding)	38.41	9.47	7.52	5.63
15	Profit / Loss *	(-) 20	221	303	324
16	Owned Funds * (Share Capital + Reserves)	55.87	707	999	1,323
17	Borrowings *(from refinancing institutions)	322	541	567	414

* in million Indian Rupees; Except (1) and (3) all other figures are in percentages

Credit

A part of the operational area of the bank nearer to New Delhi, the national capital, was getting urbanized and industrialized with number of private sector firms opening their plants and offices there. The bank looked at this phenomenon as an opportunity and devised a scheme for pay roll lending where it entered into tie-up arrangements with the corporate entities for extending loans to the employees for purchase of consumer durables, housing loans and contingency loans for domestic expenditure. The bank was able to negotiate direct pay roll deductions of all loans due. It was successful in this sector in comparison to other banks as it was the first bank to recognize the opening up of an opportunity and was able to negotiate with these industries in a skillful manner. Furthermore, the bank was able to offer competitive terms on these loans and the services were offered at the customers' doorstep. This loan portfolio enabled the bank to diversify into an area where the yield was high and recovery percentage was total. The Bank was able to fend off challenges in this segment even from private sector and foreign banks due to its strong customer service credentials and quick decision-making abilities on loaning due to the local presence of the management. It has 13,233 such loan accounts to date.

Another area where the bank has given a strong thrust was of short-term crop loans. Other than the industrialized and urbanized region adjacent to the national capital, the operational area of the bank was predominantly agricultural. The crop loans constituted just 23.27 percent of the total disbursements of the bank in 1995-96 with an amount of just over Rs.112 million. However, from that year onwards there has been a steady increase in the crop loan disbursements with the amount reaching Rs.400 million in 1999-2000 with their share in the disbursements being 51.15 percent with nearly 21,000 accounts. In 2002-03 crop loans totaled 34,428 accounts with an outstanding amount of Rs 673 million. The bank was able to increase the crop loan disbursements as it identified twenty-four branches as having abundant potential as intensive agricultural development branches. In addition, Branch Managers were delegated the powers to sanction nad/or increase the loans as per the farmers' requirements. This crop loan finance was also extended to the borrowers who had an earlier collateral linked loan without obtaining fresh collateral for the new crop loan. The norms regarding collateral were also relaxed for borrowers up to Rs.35,000. The bank also introduced overdrafts to facilitate the farmers to withdraw on the basis of their crop pledged for marketing.

The bank also introduced the Credit Card System for farmers where the farmers can operate their crop loan in a manner similar to Cash Credit account of a trader. To date the bank has issued 29,289 such credit cards. It introduced a payroll linked loan product for rural schoolteachers and a pension linked loan scheme for army and other pensioners. These schemes, which increased the loan business, also attracted more saving clientele.

Gurgaon Gramin Bank is also a very prominent RRB in the North-Western India that has ventured into microfinance. The microfinance programme of the Bank is looked after by the Women Development Cell. In the State of Haryana the largest number of Self-Help Groups, 1,900, are linked to this bank. Of these self-help groups 1,027 have been provided credit. Through the microfinance route the bank is reaching nearly 20,000 borrowers. Through this method the bank was able to maintain its loan clientele even though there was a huge contraction in the number of loan accounts due to the cleansing of the Balance Sheet of bad loans.

Savings

The bank's focus was on mobilizing low cost deposits so that low cost resources are available to it. Accordingly, the bank devised user friendly deposit schemes to tap such low cost deposits. Along with the formulation of the deposit schemes the bank ensured excellent and personalized customer service in comparison to the commercial banks in the same area. The Branch Managers often ensure service at the doorstep for many customers. Many depositors shifted to this bank after the Gramin Bank took up the deposit mobilization effort in a serious manner. The new credit products devised by the bank also had the effect of introducing a new set of savings customers for the banks. These included the employees of the firms who borrowed under pay-roll loans schemes, teachers, pensioners and army veterans in rural areas. The growth of deposits of the Bank has been so voluminous and rapid that the credit growth could not keep pace with it. With a Credit Deposit Ratio ranging between 42 to 45 percent during the years 2000-01 to 2002-03 the bank is indeed a net withdrawer of savings in its area of operations.

Investments

Until 1994-95 the bank had no avenues to deploy its surplus resources except to invest them with the sponsor bank at an interest rate set by that bank. With the RBI relaxing its restrictions on investment by RRBs from 1995-96 onwards, the Bank set up a core group at the head office to manage the investment functions in consultation with the Funds and Investment Management Department of the sponsor bank. The bank was able to judiciously deploy its surplus funds in various financial instruments available including government paper and bonds of the Central Bank and other banking and financial institutions. Income from investment was Rs. 168 million in 1994-95 reached Rs 430 million in 2000-01 and Rs.433 million in 2002-03.

Human Resource Development

An important input which the bank received was in terms of Organizational Development Intervention (ODI) conducted by the Bankers Institute for Rural Development in 1994-95 which brought about a sea change in attitude of the employees towards the position of the bank in changing financial sector environment. The ODI process helped in building up a commitment among its workforce to work towards the bank's development.

Furthermore, the bank introduced a human resource policy that entailed the creation of a smart, knowledgeable frontline staff that had a positive attitude. It took up talent management by systematically grooming and training people to take up leadership in critical positions and to find and post the right persons at the right place. The bank accelerated the training machinery by imparting periodic training to all the employees and by designing the training modules commensurate with modern day banking aspects. The training function of the bank focused on knowledge enrichment and skill development while at the same time aiming to bring about attitudinal change. This skill building enabled its employees to manage its portfolio of loans and advances as well as new deposit products in a proper manner.

Strategic Branch Approach

Under this approach fifty-eight branches, whichcontribute to seventy-five percent of the bank's total business, have been designated as Strategic Branches. Extra attention is focused on the business parameters of these branches as they are the cornerstone of progress and bank profitability.

Loan Recovery

Prior to the reform process the bank's loan portfolio was restricted to disbursing credit under the government's subsidy linked credit schemes in which a large majority turned out to be bad loans. Its loan recovery in 1994-95 was a mere fifty-one percent of loans due. The bank had implemented a multipronged strategy to recover the hardcore bad loans. Attempts made to educate the customers through recovery camps about the evils of their loan accounts turning bad has also arrested accretion of fresh bad loans. The loan recovery percentage reached eighty-five percent in 2000-01 and is estimated at eighty-eight percent for 2002-03. The loan recovery is under constant monitoring at the level of Branch Staff, Area Manager and the Head Office Recovery Department. The Chairman and General manager also participate in the recovery camps. Branches utilize the services of regular customers and Farmers' Club members to create pressure on the defaulting borrowers. The non-performing assets were brought down from Rs.322.6 million on March 31, 2000 to Rs.153.4 million as of 31 March 2003.

Diversification in business

Prior to 1994-95 apart from loans and deposit taking the bank did not have any other business products. Realizing the importance of fee based income, it gradually introduced products such as Demand Drafts, Safe Deposit Lockers, and Issue of Bank Guarantees which enabled it earn a miscellaneous income of Rs.145 million in 2002-03.

Outreach

In 1994-95, the bank had a client base of 119,697 borrowers and 522,995 depositors. Today it caters to 114,763 loan accounts and 546,328 deposit accounts. The loan portfolio of 1994-95 may be a big number, but it must be kept in mind that a large portion of that was a dead portfolio that needed to be cleansed out. While the outreach in terms of numbers has shown a steep decline immediately after the reform process, it started growing gradually from 1999-2000 onwards. At the same time the outreach deepened in terms of the average loan portfolio. The average amount per loan has increased from Rs. 8237 in 1994-95 to Rs. 21,723 in 2002-03.

The spread of the qualitative loan portfolio after 1994-95 was also positively impacted by the delegation and decentralization. Most powers of loan sanctions were delegated to Branch Managers and Area Managers, with only a few coming to the Head Office. This delegation of powers also infused a sense of accountability to ensure that loan appraisal and monitoring is proper. The number of loan accounts per branch of the bank is 602, whereas the per branch loan accounts for commercial banks in the area of operation of this RRB is 546.

Sustainability

The cost of management of the bank was 3.18 percent in 1994-95, it declined to 2.32 percent in 2000-01 and experienced a marginal increase to 2.45 percent in 2002-03. The financial margin was 2.71 percent in 1994-95, increasing to 5.35 percent in 2001-02 but slightly declined to 4.70 percent in 2002-03 on account of a steep fall in returns from investments. The Return on Assets, which was a negative 0.83 percent in 1994-95, increased to 3.26 percent in 2000-01 and then to 4.09 percent in 2002-03. The bank, which was showing a loss, started showing a profit from 1996-97 onwards. In 1997-98 it wiped out all its accumulated losses and embarked on the highway of sustainable viability. In 2001-02 it made the highest profit among all RRBs in India.

Restructuring Exercise

Under the restructuring exercise taken up by government of India and NABARD for Regional Rural Banks from 1994-95 onwards, Gurgaon Gramin Bank received Rs.182.17 million as additional share capital contribution, which enabled it to clean up its balance sheet of accumulated losses as well as bad debts. Except for this element of restructuring there has not been any change in the ownership structure of the bank, which continues to be similar to the structure at the time of its establishment. However, decision-making, except in matter of policies common to all the Regional Rural Banks, has been mostly delegated to the Board. In many operational areas where the decision-making was hitherto with the government, RBI, NABARD or the sponsor bank has now been delegated to the bank itself. This operational freedom enabled it to plan better for resource mobilization and resource deployment thereby turning around, making profits and wiping out accumulated losses, while continuing to increase its clientele.

The Outlook

With a varied clientele and outreach, with well trained and motivated staff, with a dynamic leadership, with a confidence to deal with all competitors Gurgaon Gramin Bank is set to scale higher pillars of growth in the times to come. However, if banks like Gurgaon want to maintain their positions in a competitive environment, further reforms in the RRB system are necessary.

D. THE ROAD AHEAD

These two case studies reveal that to step up the outreach of rural finances the route of reinvigorating and retooling the existing institutional variants through a series of policy interventions is a better option than to set up totally new institutions which may be a costly and time consuming affair. As it may be noticed the institutions involved did not undergo major structural changes in organization or ownership. The most important change has been the greater freedom of operation and less control of the business aspects of these banks. The banks were given the freedom to devise innovative products and also to set up strategies to market these products through which they were able to achieve the twin objectives of sustainability and outreach.

As far as subsidy dependence is concerned, the Regional Rural Bank received additional share capital infusion and an amount for the cleansing of its balance sheet. The Cooperative

Bank did not receive any financial assistance, rather it reversed subsidizes from the State government. The only concession that the government of India allows these banks is exemption from payment of income tax. Both the banks were able to achieve the breakthrough within the limited space available to them for maneuvering and coping with several constraints

Just as one swallow does not make a summer, the policy changes brought about for these institutions are not sufficient. An area of concern that must be addressed is what further reforms and changes are necessary. These include:

- The capital base of the Cooperative Bank is woefully inadequate with a capital adequacy ratio of 5.71, which does not meet the prudential norms of banking. But to increase the capital base a change in the cooperative statute is necessary, as under the existing laws non-constituents cannot hold the capital in cooperatives.

- Furthermore, the Cooperative Bank still has to function within the administrative control of the state government, which does not have a professional understanding of banking. Even the Regional Rural Bank has to seek the permissions of the government of India for many administrative matters.

- The state government's control over the cooperative banks poses difficulties for the enforcement of prudential regulation and supervision by the Reserve Bank of India and NABARD.

- Another area of concern in both the banks is of manpower. With the rapid transformation that is taking place in the banking arena there is a need for well-qualified, professional and trained staff in these institutions. In the next six years both these institutions will witness an exodus of staff on account of retirements. No plan to recruit and position staff to take care of future needs seems to be in place. The owners, the governments, do not seem to have given much serious thought to this problem. The banks should be free to evolve and implement their own policies on personnel, including recruitment, lay-off, promotion policies, training, and incentive systems.

- New information technologies provide significant scope for the adoption of innovations in bank automation, electronic data processing and development of new products. But in this field these banks have yet to catch up with commercial banks. The level of computerization in the Cooperative Bank is still in a preliminary stage. In the RRB the head office is fully computerized and forty branches have also been computerized. In this matter also, especially in the case of the Cooperative Bank, progress is hampered due to lack of operational freedom.

- The only way forward for these institutions is that both the state and central government should withdraw from these institutions and diversify their ownership. The private sector, including successful banking and financial institutions should be allowed to participate in the ownership of these institutions replacing the government. The state and central governments should desist from the urge to control and direct these institutions. These regulatory concerns can be better addressed by RBI and NABARD.

Conclusion

The lessons are clear. If the State withdraws quietly from the state-owned agricultural credit banks without prescribing policies, programs and targets, the result would not be decreased lending to agriculture and allied sectors, but the reverse, a transition to a healthy rural finance system in a manner which is both time and cost effective.

, " The time has come," the Walrus said,
"To talk of many things:
Of shoes- and ships-and sealing wax-
Of cabbages-and kings"
In '*Through the Looking-Glass' by Lewis Carroll*
The time has indeed come to talk of the need for the state's exit from rural banking.

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Notes

(i) Data on page-1 is as on 31 March 2002.
(ii) All data is from the annual reports of the case study banks and published statements and reports of NABARD and RBI.
(iii) Financial year in India (including for banks) is from 1 April to 31 March.
(iv) Data of the Case Study Banks for the year 2002-03 as on 31 March 2003 is based on provisional balance sheet figures. The final figures may undergo marginal changes after audited financial statements are available.
(v) The loan recovery data in India is calculated as on 30 June. For the year 2002-03, the figures as on 31 March 2003 have been used to extrapolate the estimates for 30 June 2003.
(vi) The exchange rate of Indian Rupee was on an average US $ 1=Rs 32 in 1994-95; US $ 1= Rs 43 in 2000-01; US $ 1=Rs 45 in 2001-02; US $ 1=Rs 47 in 2002-03.